FILE COPY

Office - Supreme Court, U. S.
FILED
FEB 9 1945
CHARLES ELMORE CROPLEY
CLERK

Supreme Court of the United States

OCTOBER TERM, 1944.

No. 932

Trust u/w of MARY LILY (FLAGLER) BINGHAM, MESSRS. WILLIAM R. KENAN, JR., and LAWRENCE C. HAINES, Trustees,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI AND BRIEF IN SUPPORT OF PETITION.

GEORGE E. CLEARY,
Counsel for Petitioner.

Pandick Press, Inc., 22 Thames St., New York 6, N. Y., U. S. A.

INDEX.

	PAGE
PETITION FOR WRIT OF CERTIORARI	1
Jurisdiction	2
The Opinions of the Courts Below	2
Statute Involved	2
Summary Statement of Matter Involved	3
Facts	4
The Decisions Below	7
Questions Presented	8
Reasons Relied on for Allowance of the Writ	9
BRIEF IN SUPPORT OF PETITION	11
Questions Presented, Statement of Case, etc.	11
Specification of Errors and Summary of Argument	11
ARGUMENT	12
I. The Circuit Court of Appeals erred in reversing the decision of the Tax Court that certain legal expenses of this trust were expenses for the management of income-producing property deductible under Section 23(a)(2), on the ground that such expenses bore no relation to such management. The relation of such expenses to the management of the income-producing property was a pure question of fact as to which the decision of the Tax Court should have been regarded as final	12
II. The Tax Court made no clear-cut mistake of law in holding that expenses of this trust incurred in winding up the trust and distributing its assets and in contesting the income tax effect of a transfer of income-producing property to a beneficiary were expenses for the management of the trust property	16
CONCLUSION	23

Table of Cases.

	PAGE
Commissioner v. *Heininger*, 320 U. S. 467, 475 (1943)	14
Commissioner v. *Scottish American Investment Co., Ltd.*, 65 S. Ct. 169 (1944)	9, 13, 15
Dobson v. *Commissioner*, 320 U. S. 489 (1943)	3, 8, 9, 13
Estate of F. C. Bartholemew, 4 T. C. No. 44 (1944)	21
Higgins v. *Commissioner*, 312 U. S. 212 (1941)	16
Higgins v. *Commissioner*, 143 F. (2d) 654 (C. C. A. 1st, 1944)	20
Hord v. *Commissioner*, 143 F. (2d) 73 (C. C. A. 6th, 1944)	20
Kenan v. *Commissioner*, 114 F. (2d) 217 (C. C. A. 2nd, 1940)	6
William R. Kenan, Jr., et al., 40 B. T. A. 824 (1940)	6
Kornhauser v. *United States*, 276 U. S. 145 (1928)	21
Manning, 3 T. C. 853 (1944)	21
McDonald v. *Commissioner*, 65 S. Ct. 96 (1944)	14, 17
Stoddard v. *Commissioner*, 141 F. (2d) 76 (C. C. A. 2nd, 1944)	20

Statutes.

Section 23(a), Internal Revenue Code	2
Section 23(a)(1), Internal Revenue Code	13
Section 23(a)(2), Internal Revenue Code	1, 3, 5, 6, 7, 8, 11, 12, 13, 16, 22
Section 121, Revenue Act of 1942, c. 619, 56 Stat. 798	2, 5
Section 162, Internal Revenue Code	3
Section 240(a), Judicial Code, as amended (28 U. S. C. A., §347(a)	2

Miscellaneous.

House Report No. 2333, 77th Congress, Second Session	17
Senate Report No. 1631, 77th Congress, Second Session	18

Supreme Court of the United States

OCTOBER TERM, 1944.

No. .....

TRUST U/W OF MARY LILY (FLAGLER) BINGHAM, MESSRS. WILLIAM R. KENAN, JR., and LAWRENCE C. HAINES, Trustees,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI.

TO THE HONORABLE THE CHIEF JUSTICE OF THE UNITED STATES AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

The above named Petitioner prays that a Writ of Certiorari be issued to the United States Circuit Court of Appeals for the Second Circuit to review a judgment of that Court rendered in the above cause on November 27, 1944 (R. 59) reversing a decision of the Tax Court of the United States which had found that there was no deficiency in the Federal Income Tax of Petitioner for the calendar year 1940 (R. 54). The Tax Court had approved the deduction under Section 23(a)(2) of the Internal Revenue Code of certain expenses for legal services and the question is whether the Circuit Court of Appeals was in error in reversing this decision.

Jurisdiction.

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended (28 U. S. C. A., §347(a)).

The Opinions of the Courts Below.

The opinion of the Tax Court (R. 36) is reported in 2 T. C. 853. The opinion of the Circuit Court of Appeals for the Second Circuit (R. 55) is reported in 145 F. (2d) 568.

Statute Involved.

The statute is Section 121 of the Revenue Act of 1942, c. 619, 56 Stat. 798, which amended Section 23(a) of the Internal Revenue Code by adding a subdivision (2). The relevant portions of Section 121 read as follows:

"Sec. 121. NON-TRADE OR NON-BUSINESS DEDUCTIONS.

(a) *Deduction for Expenses.*—Section 23(a) (relating to deduction for expenses) is amended to read as follows:

'(a) *Expenses.*—

'(1) *Trade or Business Expenses.*—

'(A) In General.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business,

of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * * * *

'(2) *Non-trade or Non-business Expenses.*—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.'*

* * * * * *

(d) *Taxable Years to Which Amendments Applicable.*—The amendments made by this section shall be applicable to taxable years beginning after December 31, 1938.

(e) *Retroactive Amendment to Prior Revenue Acts.*—For the purposes of the Revenue Act of 1938 or any prior revenue Act the amendments made to the Internal Revenue Code by this section shall be effective as if they were a part of such revenue Act on the date of its enactment."

Summary Statement of Matter Involved.

Petitioner maintains that it was entitled for the year 1940 to deduct from gross income under Section 23(a)(2) of the Internal Revenue Code certain legal fees and disbursements as expenses paid "for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income." The Tax Court held on the facts of this case that such deductions were allowable. The Circuit Court of Appeals, without referring to the decision in *Dobson* v. *Commissioner,* 320 U. S. 489 (1943), reversed the Tax Court

* This provision is made applicable to trusts by Section 162, Internal Revenue Code.

on the ground that in its opinion these expenses were not sufficiently related to the production of income or the management of income producing property to come within the statute.

Facts.

All of the facts were stipulated in the Tax Court (R. 14 to 35).

Mary Lily (Flagler) Bingham died on July 27, 1917, leaving a Will executed December 23, 1916 (R. 15). The Will (R. 19-35), after providing for certain devises of real estate and specific bequests of jewelry, provides for the conveyance to Trustees of all the residue of the property. The Trustees were directed to pay to various parties some $536,000 in cash legacies and to deliver to other parties 40,250 shares of stock of various Standard Oil Companies, as soon as compatible with the administration of the estate and the carrying out of the Testator's wishes with reference to the hotel and railroad properties mentioned in item NINTH of the Will. The Will also provided (R. 25) for the payment of $200,000 annually to a niece of the Testator until that niece attained the age of 40 years, when she was to be paid $5,000,000 in cash or securities at the discretion of the Trustees, if compatible with the interests of the estate. The Will also provided (R. 26) that the Trustees should pay $75,000 annually to the University of North Carolina during the continuance of the Trust and at the expiration thereof should pay to the University such a sum in cash as would produce an annual income of $75,000.

Item NINTH of the Will (R. 27) provided that all the rest of the estate should be held in trust for 21 years from the date of the Will for the maintenance and administration and development of the Florida East Coast Railway and the Florida East Coast Hotel properties and the properties

held by subsidiary companies. The Trustees were given broad powers to administer the trust for this purpose. The Will provided for compensation to the Trustees of $50,000 a year (R. 39).

At the end of 21 years from the date of the Will the Trustees were to divide the property then in their hands into three equal parts and transfer these to the testator's two sisters and brother (R. 39).

The Trustees of this long-term trust filed an income tax return for the year 1940, showing a tax of $312,629.27, which was duly paid (R. 15).

The Commissioner of Internal Revenue determined a deficiency in income tax of $160,815.10 by disallowing the following deductions which had been claimed on the tax return:

Compensation of Trustees	$141,369.86
Office salaries	34,934.30
Office supplies and expenses	2,448.97
Petty cash	1,722.89
Office rent, net	3,419.10
Tax and financial services	498.75
Legal expenses	25,867.31
Miscellaneous	480.75
Total deductions disallowed	$210,741.93

(R. 12).

Upon the Petitioner's petition to the Tax Court, the Commissioner stipulated that, except for the item of $25,867.31 of legal expenses, the expenses originally disallowed were ordinary and necessary expenses paid during the taxable year for the production or collection of income or for the management, conservation or maintenance of property held for the production of income (R. 16). Such items were therefore deductible under Section 23(a)(2) of the Internal Revenue Code, which was added by Section 121, Revenue Act of 1942, retroactively applicable to the year 1940.

The legal fees and expenses of $25,867.31 which remained in controversy were as follows:

(1) $16,439.96 was incurred in contesting a deficiency in income tax of the trust of $365,687.12, asserted for the year 1935. This was litigated in the Board of Tax Appeals (*William R. Kenan, Jr., et al.*, 40 B. T. A. 824, 1940) and the Circuit Court of Appeals for the Second Circuit (*Kenan* v. *Commissioner*, 114 F. (2d) 217, 1940). In this proceeding, the Courts sustained the Commissioner, in holding that the Trustees realized a gain from the sale or exchange of capital assets by exercising their power to pay partly in securities at market value the bequest of $5,000,000 payable to the testator's niece when she reached age 40 or as soon thereafter as compatible with the interests of the estate. The securities so delivered had appreciated in value since acquisition by the Trustees and it was held that such delivery in satisfaction of this bequest, although within the discretionary powers of the Trustees, was nevertheless a sale or exchange of the securities, giving rise to capital gain (R. 40).

(2) $780.25 was for services and disbursements in connection with the payment at the termination of the trust of the above mentioned legacy to the University of North Carolina (R. 41).

(3) The remaining $8,646.50 of the total of $25,867.31 in legal fees and charges paid by the trust in 1940 was for services rendered in respect of the tax and other problems resulting from the expiration of the trust and the delivery of its assets to the ultimate beneficiaries (R. 41).

The Commissioner conceded in his brief in the Tax Court that the trust property was held for the production of income, as those words are used in Section 23(a)(2) of the Internal Revenue Code (R. 45) and there was no claim that the expenses were not ordinary and necessary (R. 45).

The Decisions Below.

The Tax Court, on the facts of this case, held that the legal expenses were deductible under Section 23(a)(2) (R. 36-54). It first refused to allow the expenses as expenses of carrying on a trade or business (R. 44) and no appeal was taken from this part of the decision. It then held that the $16,439.96 expense of the income tax litigation was deductible because it found that the effort of these trustees to relieve the estate from the payment of this tax was a factor in the conservation, management and maintenance of the property of that estate, concededly held for the production of income (R. 46). Two judges who concurred in the result did not agree on this point (R. 49). The Tax Court then found, two judges dissenting (R. 49), that all of the expenses (including the expense of the tax litigation) were incurred by the trustees in the performance of one of the principal functions of the management of such property while they were in complete control of it, and hence were deductible as expenses for the management of property held for the production of income (R. 47-48).

The Circuit Court of Appeals reversed this decision (R. 55-59). The Court mentioned, but did not pass upon, the Commissioner's contention that the expenses were in the nature of capital expenditures (R. 57). It based its decision on the ground that the expense of contesting the taxes "had no relation" to the management, conservation or maintenance of property held for the production of income, because the contest was not to produce income and did not affect the yield of investment capital or its appreciation (R. 57, 58); it said that the expense of $780.85 for services in connection with the payment to the University of North Carolina "had no relation" to the production of income, or to the conservation of the property held for

that purpose because it had to do with distribution and not with management (R. 58); it said that the remaining expenses of $8,646.50 were likewise paid in connection with distribution and not with the production of income or the management of the property, were paid for services performed after the trust had ended, and that the advice "involved personal services rather than management of the trust estate" (R. 58).

The heart of the difference between the Tax Court and the Appellate Court was that the former found that these expenses were directly connected with or related to the management of the property of this trust, whereas the latter found that such expenses bore "no relation" to such management.

Questions Presented.

1. Under the principles established in *Dobson* v. *Commissioner*, 320 U. S. 489 (1943), did the Circuit Court of Appeals err in reversing the decision of the Tax Court that certain legal expenses of this trust were expenses for management of income producing property deductible under Section 23(a)(2), on the ground that such expenses bore no relation to such management?

2. Did the Tax Court make a clear cut mistake of law in holding that legal expenses of this trust incurred in winding up the trust and distributing its assets and in contesting the income tax effect of a transfer of income producing property to a beneficiary were expenses for the management of the trust property?

Reasons Relied on for Allowance of the Writ.

The writ of certiorari should be issued because the Circuit Court of Appeals violated the principles as to appellate procedure established in *Dobson* v. *Commissioner*, 320 U. S. 489 (1943), and *Commissioner* v. *Scottish American Investment Co., Ltd.*, 65 S. Ct. 169 (1944), by reversing the Tax Court on a question of fact as to the relationship of the contested expenses to the management of trust property, concededly held for the production of income. The Tax Court, on the basis of the facts of this case, directly found that the required relationship existed. The basic reason stated by the Circuit Court of Appeals for its reversal was that such expenses bore "no relation" to the management of the trust property. The Appellate Court thus differed with the Tax Court as to a pure factual inference or conclusion. Such a decision is of little value as a precedent in other cases. Review by the appellate courts of cases of this kind will require examination, analysis and the drawing of distinctions as to a body of precedents where differences in result depend primarily on differences of fact or factual conclusions.

The decision below should be reviewed in order to define more sharply the function of the Appellate Courts on appeals from the Tax Court and to discourage appeals in the large class of cases where the result depends on the relationship in a particular factual setting of the expenses claimed to either the carrying on of a trade or business or to the production of income or the management of property held for the production of income.

The decision below should be reviewed because the Circuit Court of Appeals erroneously held as a matter of law that a trust could in no event deduct as an expense

for management of property held for production of income either the expenses of settling up the trust and distributing its assets to the beneficiaries or the expenses of contesting income tax liabilities for prior years. The deductibility of particular expenses in particular cases turns on pure questions of fact. The Tax Court made no obvious mistake of law in holding that the expenses were deductible under the facts of this case. Its decision was not without rational basis. Its decision was supported by substantial evidence. The case involves an important question of Federal law, affecting every trust subject to Federal income tax, which was wrongly decided below and which has not been but should be settled by this Court.

Wherefore, petitioner respectfully prays that a writ of certiorari issue under the Seal of this Court to review the decision of the Circuit Court of Appeals for the Second Circuit in the above case, and that said decision be reversed.

Trust U/W of Mary Lily (Flagler) Bingham,
Messrs. William R. Kenan, Jr., and
Lawrence C. Haines, Trustees,
Petitioner,

By GEORGE E. CLEARY,
Counsel for Petitioner.

BRIEF IN SUPPORT OF PETITION.

Questions Presented, Statement of Case, etc.

The statement of questions presented, the statement of the case, and the statutes involved will be found in the petition.

Specification of Errors and Summary of Argument.

1. The Circuit Court of Appeals erred in reversing the decision of the Tax Court that certain legal expenses of this trust were expenses for the management of income-producing property, deductible under Section 23(a)(2), on the ground that such expenses bore no relation to such management. The relation of such expenses to the management of the income-producing property was a pure question of fact as to which the decision of the Tax Court should have been regarded as final.

2. The Tax Court made no clear-cut mistake of law in holding that expenses of this trust incurred in winding up the trust and distributing its assets and in contesting the income tax effect of a transfer of income-producing property to a beneficiary were expenses for the management of the trust property.

ARGUMENT.

I.

The Circuit Court of Appeals erred in reversing the decision of the Tax Court that certain legal expenses of this trust were expenses for the management of income-producing property deductible under Section 23(a)(2), on the ground that such expenses bore no relation to such management. The relation of such expenses to the management of the income-producing property was a pure question of fact as to which the decision of the Tax Court should have been regarded as final.

In this case it was conceded that the trust property was "held for the production of income" as those words are used in Section 23(a)(2) (R. 45, 46). There was no dispute over whether the claimed deductions were ordinary and necessary expenses (R. 45). Neither of the lower courts regarded the expenses as capital expenditures. It was undisputed that the trust was a long term trust with large assets and income and that the expenses were incurred by the Trustees in carrying out their duties under the Will creating the trust (R. 15). The Tax Court found that the expenses were incurred by the Trustees as an important part of their duties and functions in managing the trust property while they were in complete control of it, that such expenses were directly related to such management and hence were deductible (R. 46-48).

The Circuit Court of Appeals differed with the Tax Court as to the relationship of the expenditures to the management of the income-producing property and reversed on the ground that such expenses bore "no relation" to the management of the income-producing property (R. 57, 58).

Without at this point going into details as to the expenses deducted, it is submitted that the reversal of the Tax Court's decision by the Circuit Court of Appeals was erroneous under the principles set forth in *Dobson* v. *Commissioner*, 320 U. S. 489 (1943) and *Commissioner* v. *Scottish American Investment Co. Ltd.*, 65 S. Ct. 169 (1944) because the relationship of these expenses to the management of the income-producing property held by these trustees is purely a question of fact. The Tax Court's determination of such fact, if supported by substantial evidence, is final.

Every case in which the deduction of expenses is claimed involves a question of fact as to whether such expenses are incurred "in carrying on any trade or business" if the claim is made under Section 23(a)(1) or are incurred "for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income" if the claim is made under Section 23(a)(2). Where, as in this case, the controversy is one as to *the relationship* in the particular case of the expense to the business, the income, or the income-producing property, the factual inference or conclusion of the Tax Court as to whether or not such relationship is sufficiently close to warrant the deduction is obviously of little value as a precedent in other cases.

There is no rule of law which indicates that the Tax Court's decision in this case was without rational basis. The Tax Court made no clear-cut mistake of law. It was not unreasonable for the Tax Court to conclude that these expenses of this trust were deductible under Section 23(a)(2) when it was established by substantial evidence that the trust property was held for the production of income, that the expenses were ordinary and necessary expenses and were incurred by the trustees in carrying

out the provisions of the trust at a time when the property was still under their complete control.

In *Commissioner* v. *Heininger*, 320 U. S. 467, 475 (1943), the Court said, in a controversy as to the deduction of business expenses:

> "Whether an expenditure is directly related to a business and whether it is ordinary and necessary are doubtless pure questions of fact in most instances. Except where a question of law is unmistakably involved a decision of the Board of Tax Appeals on these issues, having taken into account the presumption supporting the Commissioner's ruling, should not be reversed by the federal appellate courts. Careful adherence to this principle will result in a more orderly and more uniform system of tax deductions in a field necessarily beset by innumerable complexities".

In this case the Court reversed the Board of Tax Appeals solely because it had proceeded upon a mistaken conviction that denial of the deduction claimed was required as a matter of law.

In *McDonald* v. *Commissioner*, 65 S. Ct. 96 (1944), involving the deductibility of campaign expenses of a judge seeking election, the Court affirmed a decision of the Tax Court denying the deduction. The opinion states that the Court would not be inclined to displace the views of the Tax Court with its own views in a case of this kind. The Court said:

> "We are therefore relieved from discussing the numerous cases in which the Tax Court or its predecessor, the Board of Tax Appeals, allowed or disallowed deductions and their bearing on the situation before us. To do so involves detailed analysis

> of the special circumstances of various 'businesses' and expenses incident to their 'carrying on.' We shall not enter this quagmire of particularities."

In the dissenting opinion, it is said

> "Were the expenses incurred in an effort to produce income? Were these expenses, or part of them, 'ordinary and necessary' in connection with that effort? These are in most instances purely questions of fact and in cases such as this are to be determined by the tax court."

The present case is one of a class to which is fully applicable the following statement of the Court in *Commissioner v. Scottish American Investment Co., Ltd.*, 65 S. Ct. 169 (1944):

> "Moreover, this case exemplifies one type of factual dispute where judicial abstinence should be pronounced. The decision as to the facts in this case, like analogous ones that preceded it, is of little value as precedent. The factual pattern is too decisive and too varied from case to case to warrant a great expenditure of appellate court energy on unraveling conflicting factual inferences."

If the decision below is allowed to stand, taxpayers and the Commissioner will be encouraged to ask appellate courts to review decisions of the Tax Court as to the deduction of expenses where the sole issue is the relationship of the particular expense under the facts of the particular case to the business carried on, the income produced or the income-producing property held. For a period of years, while these cases are pending, the Tax Court will be hampered in making a systematic, orderly and uniform application of the statutory provisions to the facts of particular cases.

For these reasons, it is submitted that the action of the Circuit Court of Appeals in reversing the Tax Court's decision in this case was erroneous and contrary to the principles as to judicial review of Tax Court decisions established by this Court.

II.

The Tax Court made no clear-cut mistake of law in holding that expenses of this trust incurred in winding up the trust and distributing its assets and in contesting the income tax effect of a transfer of income-producing property to a beneficiary were expenses for the management of the trust property.

Section 23(a)(2) allows the deduction of ordinary and necessary expenses paid or incurred during the taxable year

(1) "for the production or collection of income",

(2) "or for the management, conservation or maintenance of property held for the production of income".

The amendment obviously does more than allow the direct expenses of producing or collecting current income, which are covered by the first part of the clause. The statute allows in addition the deduction of expenses for the management, conservation or maintenance of income-producing property.

The Committee Reports show that Congress intended that the section should be broadly applied to allow the deduction of ordinary and necessary expenses incurred in connection with investment income and property, thus curing the inequity of the prior statute made manifest by the decision in *Higgins* v. *Commissioner*, 312 U. S. 212

(1941) and conforming to the broad basic policy of "taxation on net, not on gross income," (dissenting opinion *McDonald* v. *Commissioner*, 65 S. Ct. 96, 1944).

In House Report No. 2333, 77th Congress, Second Session, pages 46, 75, the Ways and Means Committee said with respect to this provision

> "Thus, whether or not the expense is in connection with the taxpayer's trade or business, if it is expended in the pursuit of income or in connection with property held for the production of income, it is allowable. • • •
>
> "Ordinary and necessary expenses so paid or incurred are deductible under section 23(a)(2) even though they are not paid or incurred for the production or collection of income of the taxable year or for the management, conservation, or maintenance of property held for the production of such income. The term 'income' for this purpose comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years, and is not confined to recurring income but applies as well to gain from the disposition of property. Expenses incurred in managing or conserving property held for investment may be deductible under this provision even though there is no likelihood that the property will be sold at a profit or will otherwise be productive of income."
>
> • • • • • •
>
> "Expenses, to be deductible under section 23(a)(2) must be ordinary and necessary, which rule presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of income or to the management, conservation or maintenance of property held for that purpose."

The report of the Senate Finance Committee is to the same effect. (Senate Report No. 1631, 77th Congress, Second Session, pages 87-88).

The statutory provision in question is not an exemption clause, as it was characterized by the court below (R. 79), but a deduction clause covering items which "can conveniently come within" its "clear provisions" (*McDonald* v. *Commissioner*, 65 S. Ct. 96, 1944).

In view of these principles we submit that the Tax Court made no clear-cut mistake of law in allowing the disputed items as deductions under the facts of this case.

The taxpayer was not an individual, but a long-term trust, holding property for the production of income. There was no claim that the expenses were not ordinary and necessary. It was not denied that everything the trustees did was pursuant to their powers and duties under the trust instrument and that the expenses were incurred while the property was under their complete control. The Commissioner had conceded that the trustees' compensation, the office salaries, the rent and other expenses were fully deductible with no attempt to allocate any part of these to activities in connection with winding up the trust or distributing its assets, or the income tax litigation.

In this setting the Tax Court approved the deduction as expenses of management of income-producing property of the following items:

1. Deduction was allowed of $16,439.96 of legal fees and charges paid in contesting a 1935 income tax deficiency of $365,687.12. With respect to this deduction the Tax Court said

> "The effort of petitioners in seeking, through this litigation, to give such relief to the estate (relief from payment of the deficiency in income tax) was,

> in our opinion, obviously a factor in the conservation, management and maintenance of the property of the estate concededly held for the production of income, since in resisting the imposition of the tax the trustees were performing the required duty of protecting and defending the trust property in their hands against any claim or lien for the tax" (R. 46).

2. This same item of $16,439.96, and the additional expenses of $9,427.35, were allowed as deductions by the Tax Court on the ground that they were all expenses paid for the management of the trust property. The additional expenses involved problems arising out of the payment of a bequest to the University of North Carolina, the expiration of the trust and the distribution of its assets to the legatees (R. 47).

The Tax Court said

> "Such payment and distribution were made by the trustees as directed by the will and as a part of their duties in managing the trust property" (R. 47).

It further said that the expenses of "settling up" the trust estate were deductible

> "since one, if not the most, vital duty imposed on those trustees was to make proper distribution of such property, and in making it they were performing one of the principal functions of the management of such property, since until that property reached the hands of the legatees and distributees the trustees were in complete control of it and thus its management" (R. 47, 48).

The concurring judges agreed on the ground that "the management of the property of the estate embraced the proper disposition of it pursuant to the will of the decedent" (R. 49).

The Circuit Court of Appeals reversed on the ground that expenses of contesting taxes and settling up the trust had "no relation" to the management, conservation or maintenance of property held for the production of income (R. 57, 58).

The Circuit Court of Appeals was wrong in laying down a rule of law that the expenses of contesting an income tax deficiency for prior years could never be an expense for the management of income-producing property even where, as here, the taxpayer was a trust holding income-producing property and the transaction in controversy was a transfer of income-producing property to a beneficiary held to give rise to a taxable gain to the trust. It is for the Tax Court to determine from the facts of the particular case whether or not such an expense is an ordinary and necessary expense for management of property held for the production of income.

The three cases cited by the Circuit Court of Appeals on this point, in all of which the Tax Court or its predecessor was affirmed as to this question, established no rule of law. In *Stoddard* v. *Commissioner*, 141 F. (2d) 76 (C. C. A. 2nd, 1944), the decision simply was that an individual taxpayer could not deduct expenses of contesting prior years' income taxes where there was no proof of the nature of the controversy. (See 47 B. T. A. 584, 588.) In *Higgins* v. *Commissioner*, 143 F. (2d) 654 (C. C. A. 1st, 1944), the Court refused to hold that the statute in all cases allowed as expenses of management the deduction of expenses in connection with income tax controversies, the court's view being that the deductibility of such an item was a question of fact in each case. In *Hord* v. *Commissioner*, 143 F. (2d) 73 (C. C. A. 6th, 1944), the expenses disallowed were with respect to a controversy over an undescribed income tax refund for 1928 and the determination of an undescribed deficiency for 1929. In none of these cases did the proof

submitted establish any connection between the expenses claimed and the management of income-producing property.

The Tax Court, although strictly requiring taxpayers to prove the nature of the expenses and their connection with the production of income or the management of income-producing property, has in other cases allowed the deduction of expenses of income tax controversies particularly where, as in this case, the controverted transaction was one which itself gave rise to taxable income (*Manning*, 3 T. C. 853, 1944). The Tax Court's view is that if the original transaction was proximately related to the production or collection of income, any litigation arising out of that transaction involving its tax consequences would also proximately relate to the production or collection of income", and the fees and expenses in connection with such litigation would be deductible. This view was confirmed in *Estate of F. C. Bartholemew*, 4 T. C. No. 44 (1944) and is supported by the reasoning in *Kornhauser* v. *United States*, 276 U. S. 145 (1928).

The Circuit Court of Appeals was also wrong in laying down a rule of law that the expenses of a trust in connection with the winding up of the trust and the distribution of its assets can never be an expense of the management of trust property. That too is a question of fact in each particular case as to which the determination of the Tax Court should be final.

The establishment of a long-term trust is one common method employed for the management of income-producing property. In every such case, some expense is involved in connection with the winding up of the trust, the distribution of the trust property and the accounting to the beneficiaries at the termination of the trust. The trustees and their employees, accountants and attorneys must devote

time and attention to this most important function and activity. How can it be said that there is no rational basis for regarding these services as a part of the management of the trust property? How can it be held as a matter of law that expenses incurred in carrying out this trust duty of distributing the trust property bear "no relation" to the management of the trust property?

The view of the Circuit Court of Appeals seems to be that no expense is deductible under Section 23(a)(2) unless it is incurred for the specific purpose of producing income through increasing yield or causing appreciation in value of the property held (R. 58). Congress adopted no such impracticable rule. By the plain terms of the statute, in addition to the expenses for the production or collection of income, there is deductible the ordinary and necessary expense incurred for the management, conservation or maintenance of income-producing property.

Under the view adopted below, the Commissioner would be obliged in every case to analyze the activities of trustees and their employees, and to deny as a deduction any part of the trustees' compensation, the salaries paid to employees and the fees paid to accountants and attorneys which had to do with the settling up of the trust and the distribution of its assets, or with income tax controversies. Taxpayers would have to prove that every deduction claimed for trustees' fees, investment management fees, office expense, employees' salaries and fees to attorneys and accountants, incurred in connection with the management of income-producing property, was incurred for the specific purpose of producing or collecting present or future income, and had nothing to do with income tax controversies or with winding up a trust. The statute would be construed and applied as if it allowed deductions only of expense "for the production or collection of income". The Congressional mandate that

in addition there was deductible expenses for the management, conservation or maintenance of income-producing property would in large measure be disregarded.

In every case, of course, a determination of fact must be made as to whether the deduction claimed bears a reasonable and proximate relationship to the production or collection of income or to the maintenance, management or conservation of income-producing property, or to carrying on a trade or business. It may be difficult in many cases to draw the line, but it is respectfully submitted that it is the function of the Tax Court to determine in particular cases where the line should be drawn and that the appellate courts should not concern themselves with such questions of fact.

Conclusion.

For the foregoing reasons it is respectfully submitted that the petition for writ of certiorari to the Circuit Court of Appeals for the Second Circuit should be granted.

Respectfully submitted,

GEORGE E. CLEARY,
Counsel for Petitioner.